Bank Pekao
Corporate & Investment Banking

New opening

Challenges faced by Polish companies as a driving force of M&A market

Table of contents

Introduction

Even though Poland is already the centre of investors activity in the whole region, the domestic M&A market has greater potential than statistics suggest. This is the key message of our unique report on a M&A market in Poland, in which we point out main trends that have shaped it throughout recent years and key factors seen as its driving force in the nearest future. **We estimate that M&A transactions in Poland could reach a total annual value as EUR 15 bn (i.e. about two times more than 2016-2018 on average).**

Increased M&A activity would be a welcomed and favourable phenomenon for the Polish economy, being a partial answer to its structural challenges (unfavourable demographics pressure on labour costs combined with strong fragmentation and low innovativeness of a number of sectors) and global trends (in particular comprehensive digitalization). On the other hand, expected intensification of these phenomena in the next years should be an incentive for faster consolidation of the Polish market. Mergers and acquisitions can also become an effective way to expand abroad, something Polish companies did less frequently in the past than their regional competitors.

In the coming years, the M&A market will be characterized by stronger activity, as well as growing complexity of transactions. They will not only be of larger size, but more often include some elements of internationalization, professional investor like Private Equity funds or more sophisticated financing. In many cases they will also cover the complex problem of succession among Polish family-owned firms. **Under such circumstances even more emphasis will be put on comprehensive offer and unique solutions provided by professional and experienced team of advisors. Pekao Group, being a long standing leader of corporate and investment banking in Poland, is their absolute guarantor.**

Michał Krupiński
CEO,
Bank Pekao S.A.

Tomasz Styczyński
Deputy CEO,
Corporate & Investment Banking Division,
Bank Pekao S.A.

Potential of the Polish M&A market

The report conveys a quite **positive view of the Polish mergers and acquisitions market**:

1. **Poland remains the main driving power of the M&A market in Central Eastern Europe**, with every third transaction in the region taking place here and nearly half of 30 top transactions in last 3 years concerning Polish entities. Moreover, a total value of transactions increased by over 20% compared to years 2013-2015, whereas in other CEE countries recorded a ca. 10% fall.
2. **Average value of a single M&A transaction in Poland is growing** (by over 30% versous to 2013-15 period), though quite a strong inclination towards smaller deals is still observed (with over 50% valued less than EUR 25 mn).
3. **The role of Private Equity funds is increasing substantially.** In 2016-18 they made up about 30% of total mergers and acquisitions value. For many of them Poland serves as the first stop on their way to expansion in the region. This trend is likely to continue, as PE funds are well suited to play an integrating role on fragmented markets.

At the same time, Polish market still has an above-average development potential – in neighbouring Czech Republic the M&A market value to GDP ratio two times higgher than in Poland, while in most developed European M&A markets (e.g. UK) even four times higher. Morover, numerous phenomena speak in favour of growing domestic market in the future:

1. **Poland still underperforms in comparison to other CEE countries in terms of cross-border transactions** (48% of deals in 2016-18 vs. 60% on average in other countries of the region). We believe that their role will be growing, partially supported by mentioned increasing activity of financial investors, but also e.g. by more attractive valuations of Polish companies amid global slowdown and increased supply of enterprises for sale. We expect higher interest of foreign investors

Maciej Jacenko
CEO,
Pekao Investment Banking S.A.

The M&A market in Poland, similar to others in the region, enters a new era which will be shaped by industry 4.0 revolution. Polish companies are not in a lost position in the new competitive race and moreover, they can emerge from it as winners.

However, to fully exploit the development potential stemming from digitalization, CEE companies need to start joining forces. The region, and especially Poland, is rich in high-quality human capital that can and should be the foundation of future economic success. Companies in the region still do not fully utilize economies of scale. They are mostly limited to local relatively small markets, while being essential to take a big leap into the future.

I strongly believe that in the coming years the Polish M&A market will experience revolutionary changes, characterized by:

- much faster consolidation of many sectors of the economy, including growing number of cross-border mergers and acquisitions (with CEE companies standing on both sides of the transaction),
- substantial increase of Polish firms' activity on foreign M&A markets – not only in the region, but also in Western Europe,
- M&A driven rapid development of Polish technological start-ups – perhaps in few years we will see the first Polish "unicorn".

especially in several areas of Polish economy – technology sectors can serve as an example, as Poland offers an access to wide range of high-quality and still relatively cheap intellectual capital.

2. **Growing number of family-owned companies face succession challenges** – Polish capitalism is already 30 years old and upcoming generational change in family-controlled enterprises seems inevitable. For a number of owners, monetization of their businesses by selling them to external investors remains one of the main alternatives.
3. **Faster development of the hitherto dormant mid-market may also become one of the important growth drivers in the near future.** Over the past years, Polish medium-sized companies have significantly expanded, becoming an attractive acquisition target, but also a potential active acquirer on this market.

Some important structural challenges should accelerate consolidation trend among Polish companies. The labour market is now entering a stage of deep demographic low – over 1.5 mn workers will disappear from the market by 2025, causing growing pressure on operating costs. Meanwhile, digital revolution taking place right before our eyes will change business models, into ones, where competitive advantages are mostly based on innovation and technology. To tackle these challenges Polish enterprises will have to increase scale of activity, raise their productivity and above all invest much more actively in digitalization, automation of processes and development of human capital. Growth through M&As appears to be one of the solutions to these challenges.

In our opinion, upcoming years will be marked not only by growing importance of Poland on regional mergers and acquisitions market, but also greater role of Polish companies as integrators of several sectors in this part of Europe. From the domestic entities' point of view, capital expansion in the region is an effective way of overcoming growth barriers such as increasing saturation of local demand (gaining shares on new markets) or technological delay (acquisitions of smaller innovative firms). A number of Polish enterprises have reached a size that allows them to play the role of regional stars, setting the trends in many areas of the economy.

POLISH M&A MARKET IN NUMBERS (2016-2018)

>400
of M&A deals were completed on Polish market in past 3 years

EUR 121 bn
was an average transaction value on Polish market (+31% vs. 2013-2015)

48%
of all aquisitons on Polish market were carried out by foreign investors

EUR 22 bn
was their total value, which made up...

13
out of 30 largest deals in the region concerned Polish companies

21%
Private Equity funds were involved in every fifth M&A transaction on Polish market

...37%
of overall value of M&A market in the CEE region

21%
of all the transactions were completed in manufacturing and associated sectors

72
foreign aquisitions were completed by Polish firms

KEY DRIVERS IN THE FUTURE

Favourable macroeconomic environment
(solid economic growth, low interest rates)

GDP +4,1%
per annum in years 2019-2020

Growing cost pressure on Polish firms
(demographic and its impact on labour market)

-1,7 mln
number of workers until 2025

High fragmentation of Polish enterprises sector
(potential for consolidation)

x7 lower av. turnover vs. German firms

Challenges associated with
succession in Polish family-owned companies

57%
Polish companies set up before 2000

Source: Mergermarket, StatOffice, Eurostat, Institute for Family Business

Poland remains at the core of M&A activity in the CEE region

In the last 3 years, as many as 1/3 of all M&A transactions in the region concerned Polish enterprises. Their total disclosed value reached EUR 22 billion. As the local market matures, its structure shifts more and more towards larger transactions. The activity of foreign investors is also growing, with Private Equity funds playing a particularly important role in its development.

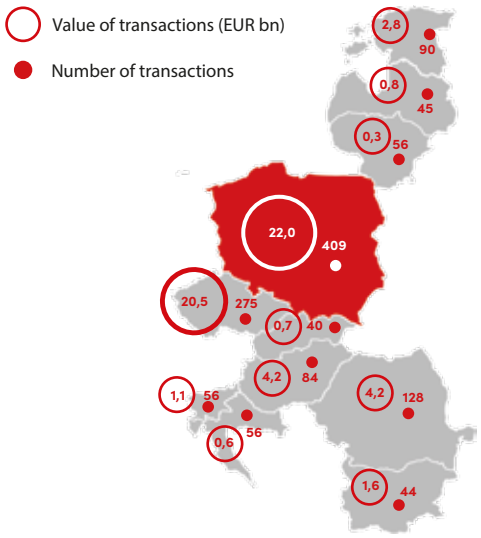
The Polish M&A market shows regional strength and positive mid-term trends...

Over the last 3 years (2016-2018) more than 400 M&A transactions were concluded on the Polish market, a number very similar to that from the years 2013-2015. At the same time **their cumulative value**[1] **increased by as much as 22%, to ca. EUR 22bn**. Such a strong growth rate was exceptional, as the cumulative value of disclosed deals in all other CEE countries declined by ca. 10%. At the single country level higher dynamics was reported only on a few smaller markets (Romania, Estonia).

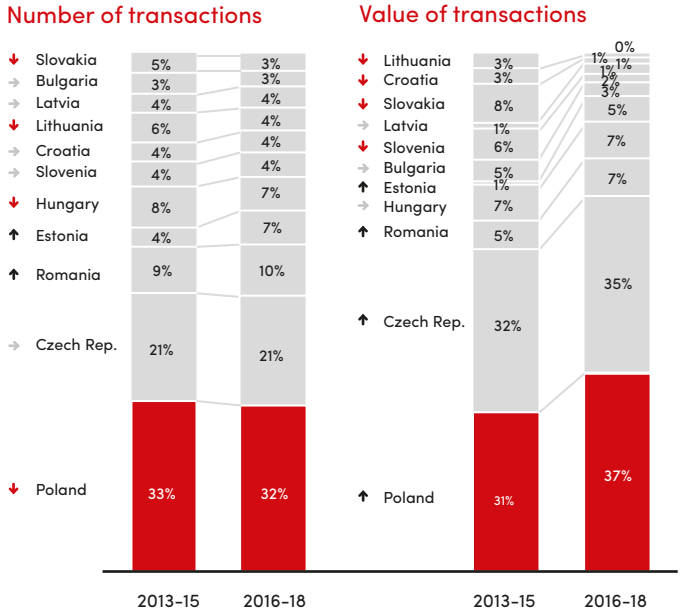
Poland's dominant position in the region is reflected in some other statistics – within last 3 years it accounted for **32% of total deal number and 37% of their disclosed value**[2] (with the latter share increasing 6 pp vs. the 2013-2015 period).

M&A market in Poland and other CEE countries, 2016-2018

Number and value of M&A transactions, 2016-18



% share of individual countries



Source: Mergermarket

Recorded increase in the domestic market value has been supported by the growing number of larger transactions. While majority of deals were still focused on small entities (with a unit value of up to EUR 25m), the share of transactions ranging EUR 50-250m increased significantly (+9 pp vs. 2013-2015 period). **It reflects a positive trend of Polish market which enters into a new stage of development, characterized by faster development of the hitherto dormant "mid-market" segment.** However, the "lower-mid" and "mid" value transactions (ranging EUR 25-100m) are still somewhat lagging behind the CEE region.

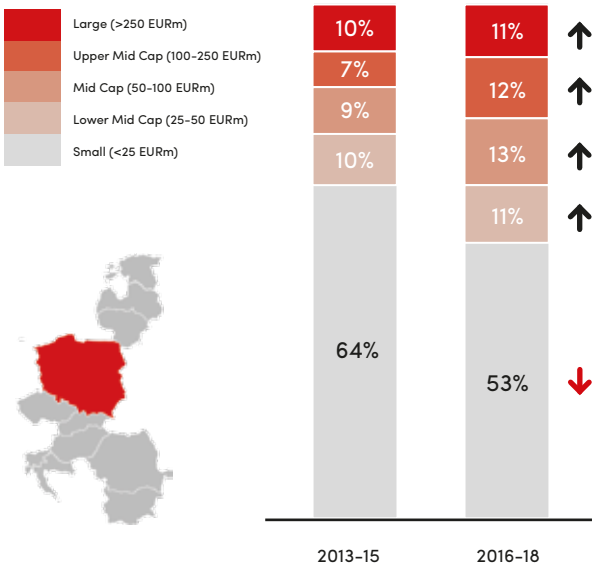
Despite high number of relatively small deals, the Polish M&A market value is still to large extent affected by the occasional large-scale transactions (a phenomenon typical for all countries in the CEE region). The largest deals (worth over EUR 1bn) are relatively rare – in 2016-18 Poland reported 4 such transactions (Allegro Group, Bank Pekao SA, Żabka and Polish assets of EDF), out of 11 conc-

[1] Value of transactions is defined as value disclosed to the public (it does not include transactions with no disclosed value). Average value of transaction is calculated only for transactions with disclosed value.
[2] Poland and the Czech Republic are both strong regional leaders, as they account for 53% of the total number of transactions and as much as 72% of disclosed value arranged in all CEE EU-member countries.

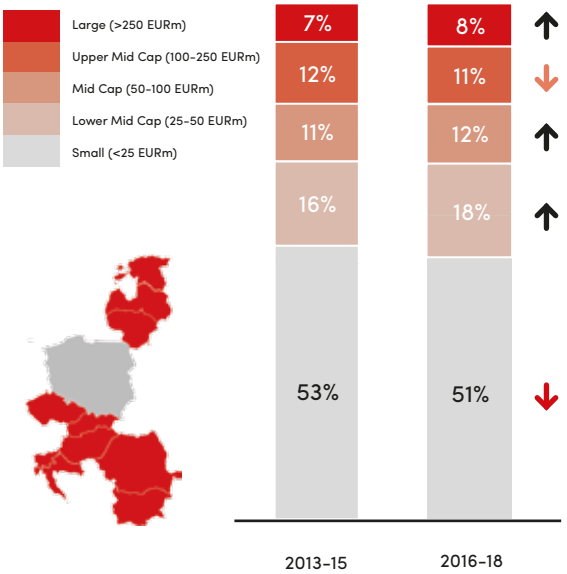
luded in the whole region. In turn, **out of 30 largest transactions in the CEE region in 2016-2018 period, as much as 14 were "Polish" deals** (13 with local companies as targets and 1 with Polish company taking over other CEE entity), **accounting for 36% of their total value**. It shows that **not only Poland attracts the highest number of M&A deals in the region, but also there is a strong concentration of largest deals and investors on its local market**.

Structure of the Polish M&A market* (by deal size), 2016-2018 vs. 2013-2015

Poland



CEE coutries (excl. Poland)



* Shares in total number of transactions with disclosed value
Source: Mergermarket

...however last year brought a temporary decline in M&A activity both in Poland and the whole region. Brexit, geopolitical uncertainty and expected global slowdown are among the key drivers.

In 2018 alone 125 M&A deals were announced in Poland, representing a 15% yoy decline. Their disclosed value came at EUR 4.6 bn, 35% down from 2017. Taking into account exceptionally good macroeconomic readings and record-high financial results of Polish companies, such drop could be surprising. **However, it seemed to be of rather temporary than permanent character, due to such factors as**:

- **Brexit and other geopolitical tensions, not directly linked to the CEE region economic situation, but resulting in increased uncertainty.** They were mentioned by investors as the most important disincentives affecting negatively the whole region (total value of CEE deals in 2018 was only half of that in 2016);
- **relatively high valuations of Polish enterprises** elevated by their strong financial results - high expectations of potential sellers may have discouraged bidders, especially in the face of expected economic slowdown;
- **high volatility typical for M&A markets in all CEE countries** (especially in terms of transaction value) - for example, in 2016 just 2 deals (Allegro Group and 33% stake in Bank Pekao, worth EUR 5.3 bn) accounted for as much as 51% of total market value, while in 2018 there was no single deal worth over EUR 1 bn.

Large scale and diversity of Polish economy brings a wide range of business opportunities for investors. Their activity concentrates on Poland's industrial specializations as well as innovative high-tech sectors

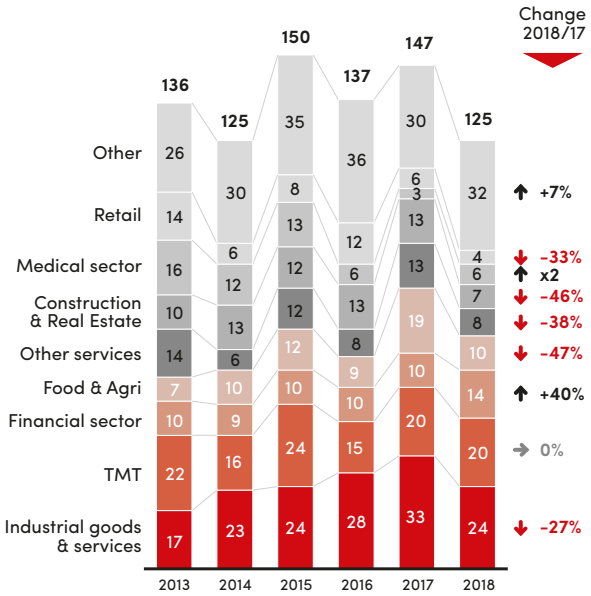
In 2016-2018, the highest number of transactions in Poland were announced in sectors of industrial goods & services, TMT, food industry and financial services, which in total accounted for 51% of all transactions. Concentration of activity in these sectors was due to:

- structural challenges (regulatory and technological) or ongoing process of "repolonization" in financial services,
- Poland's strong specialization and international competitive position combined with high fragmentation in industry and agri-food sector,
- fast expansion of innovative and technological-ly advanced TMT companies (including start--ups).

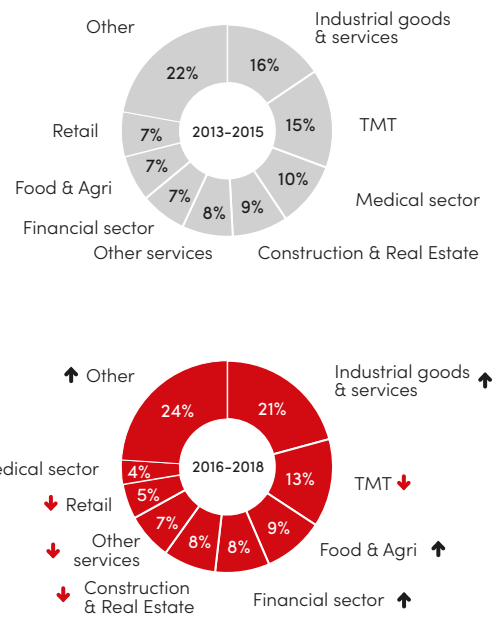
The sectoral structure of Polish M&A market is similar to that in other CEE countries. The main differences include stronger share of industry and agri-food and lower share of some services (e.g. transportation, accommodation and gastronomy). Nevertheless, in almost every area (except for services) Poland reports the highest number of M&A deals among CEE countries. That only proves that **large scale and diversity of Polish economy attracts investors with wide range of business opportunities, while many smaller countries of the region offer them mainly in quite narrow areas of specialization**.

Polish M&A market - sectoral view, 2013-2018

Number of transactions by sector



% shares of individual sectors*



* Shares in total number of transactions
Source: Mergermarket

The Polish M&A market relies strongly on domestic bidders. However, the activity of foreign investors is growing, especially in terms of number of deals

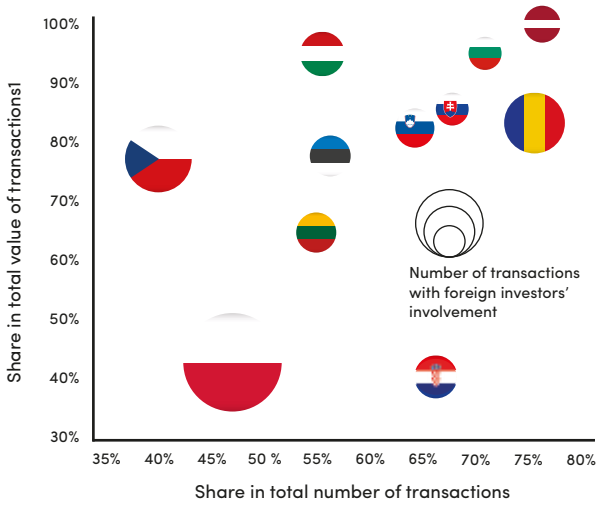
The bidder side of the Polish M&A market is almost equally represented by domestic and foreign investors, with the latter being responsible for 48% of all transactions in the 2016-2018 period (an increase of 4 pp vs. 2013-15). At the same time their value share declined from 48 to 44%, which was associated with increased engagement of state-controlled companies in some large-scale transactions.

The role of foreign investors on the Polish M&A market is still significantly smaller as compared to the region. In other CEE countries foreign investors were responsible for about 60% of the total number of deals concluded in 2016-18 and as much as 80% of their disclosed value. It suggests, that **Polish firms have already achieved a critical mass allowing them to play much more significant role in consolidation of domestic market than their regional counterparts**. Expanding M&A activity to foreign markets should be the next natural step in their development, as they are in a favorable position to play more important role in the region. At the same time it shows **some additional space for growth resulting from potentially higher activity of foreign investors in the future**.

In some sectors (e.g. food production or industrial goods & services) **foreign investors are already the main driving force of M&A transactions** (nearly 60% of all deals). Their presence is also strong in real estate. Whereas, domestic investors dominate in retail trade and medical industry (about 2/3 of deals), playing also a leading role in financial services (to a large extent – due to the already mentioned process of "repolonization").

US entities were the most active foreign investors on the Polish M&A market (being responsible for 14% of all deals completed in the 2016-2018 period), followed by companies from UK, Germany and France.

The role of foreign investors on CEE M&A markets, 2016-2018



The growing activity of Private Equity funds becomes one of the main drivers of the Polish M&A market

The increasing presence of financial investors, including Private Equity funds, seems to confirm the high attractiveness of the Polish M&A market. In the 2016-2018 period, PEs participated – on the bidder or / and seller side – in every 5th transaction completed locally. Their share in total disclosed value of M&A transactions stood at 30% and doubled versus the previous 3-year period. **Only on two markets of the region** (Estonia, Romania) **institutional investors play a more distinct role**.

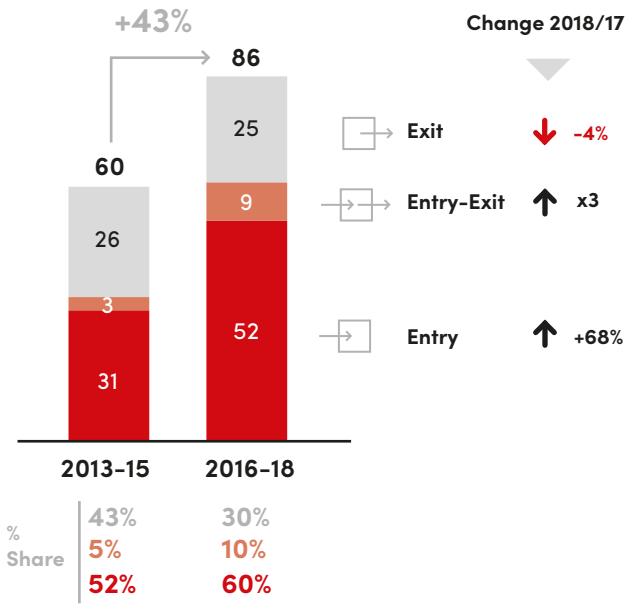
Within last 3 years Poland attracted 35% of all transactions carried out by PEs in the CEE region, which translated into 43% of their disclosed value. The latter share has grown vs. 2013-2015 period by 11 pp. **In 2018** their activity was **additionally supported by historically high number of companies delisted from the Warsaw Stock Exchange (22 cases vs. only 7 debuts), creating opportunities for takeovers**.

Importantly, **in the last 3 years PEs acted as bidders in 61 transactions, compared to 34 in the period 2013-2015**. At the same time, the number of exits grew only slightly. **It not only signals their growing interest in the Polish market, but also – considering the PEs' investment cycle – may be a sign of an increased traffic in opposite direction in the near future.**

The number of PEs active on the Polish M&A market remains in an upward trend with around 40 institutional investors present on the bidder side and 8 of them participating in this role in at least 3 transactions within the 2016--2018 period. Some business areas are especially popular among them - **nearly 40% of all deals with PEs' involvement took place in the industrial and TMT sectors**.

Structure of M&A transactions completed by PE funds (by type), 2016-2018

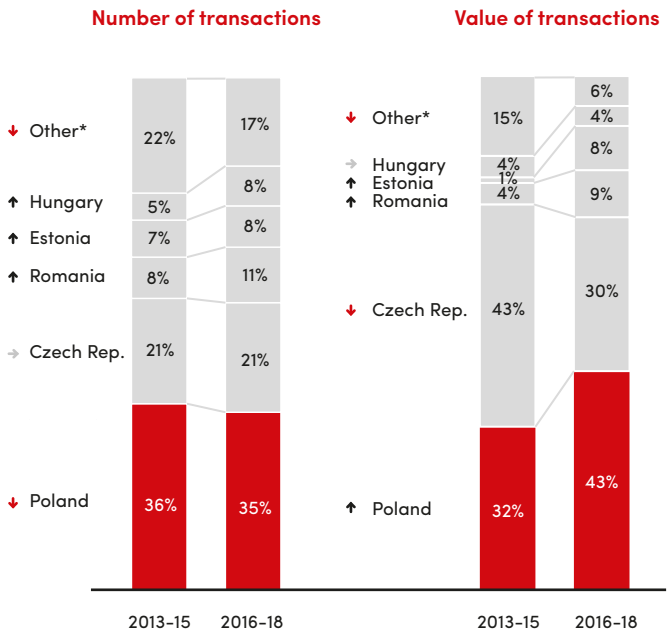
Number of transactions



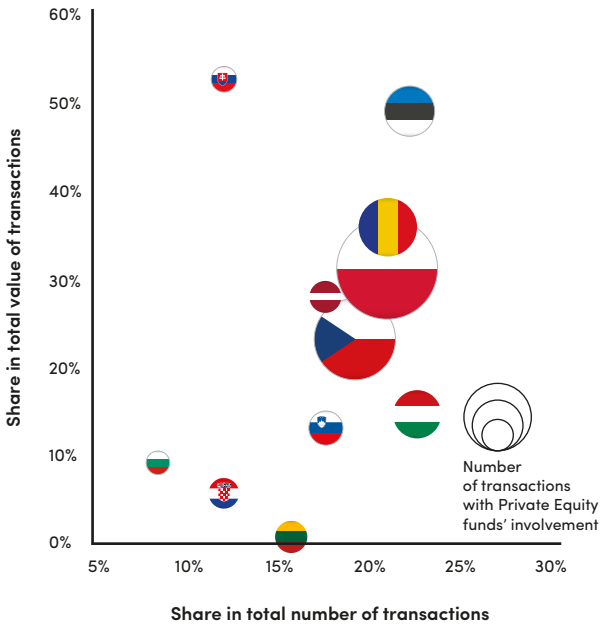
Source: Mergermarket

Activity of Private Equity funds on individual CEE M&A markets

Structure by country



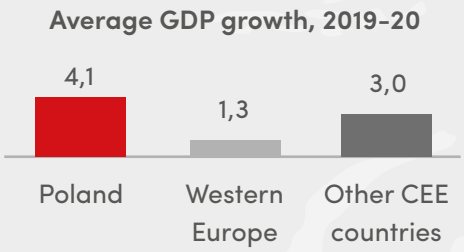
Role of Private Equity funds on particular markets

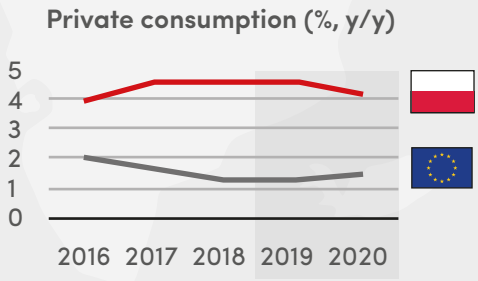


* Slovakia, Bulgaria, Slovenia, Croatia, Lithuania and Latvia
Source: Mergermarket

Macro outlook – what will the near future bring?

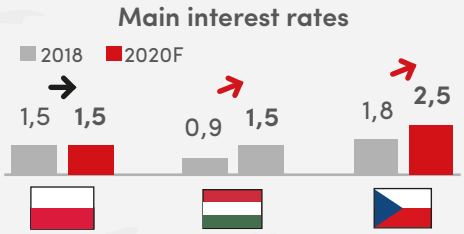
Despite slowdown, Poland remains one of the fastest growing economies in the EU

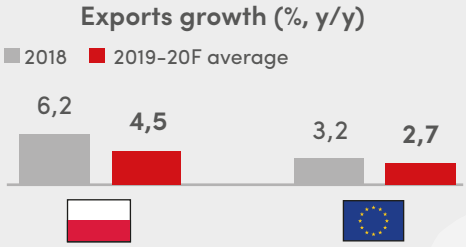




Consumer boom is expected to last, fuelled by situation on labour market

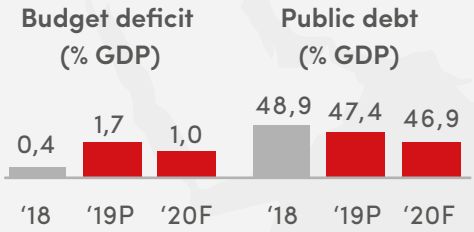
Interest rates should remain on record-low levels, supporting investments





Exports might slow down slightly, but its pace will be still relatively high

Even with expansive social policy, budget deficit and public debt will stay under control



	Indicator	2016	2017	2018	2019P	2020P	2021P
Growth	GDP (%, y/y)	3,1%	4,9%	5,1%	4,5%	3,7%	3,0%
	Private consumption	3,9%	4,5%	4,5%	4,4%	4,2%	3,0%
	Investment	-8,2%	4,0%	8,7%	7,2%	5,0%	2,5%
Stability	CPI inflation (%, y/y, eop)	0,8%	2,2%	1,1%	2,5%	2,7%	2,5%
	Budget balance (% GDP)	-2,2%	-1,5%	-0,4%	-1,7%	-1,0%	-2,8%
	Public debt (% GDP)	54,2%	50,6%	48,9%	47,4%	46,9%	47,5%
	Current account (% GDP)	-0,5%	0,2%	-0,7%	-1,0%	-1,4%	-1,4%
Labour market	Employment* (mn persons, eop)	5,799	6,064	6,233	6,414	6,502	6,522
	Avg. wage* (PLN th, eop)	4,636	4,974	5,275	5,681	6,012	6,331
	Unemployment rate** (%, eop)	8,2%	6,6%	5,8%	5,4%	5,4%	5,5%

*Data for enterprises sector ; ** Registered unemployment. Sources: Bank Pekao, European Commission, Bloomberg

Key factors behind high activity on the Polish M&A market

High activity observed on the Polish M&A market results not only from large scale of the local economy, but also from attractive conditions it creates for domestic and international investors. Dynamic economic growth, strong financial position of Polish enterprises as well as favourable business climate support M&A transactions of increasing value.

Poland is a relatively large economy with one of the fastest growth rates in Europe

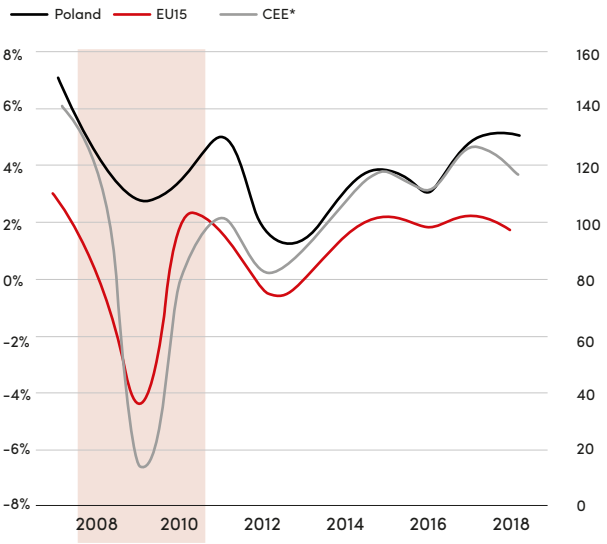
Poland is the largest economy among all CEE countries, accounting for 36% of their total nominal GDP – more than the Czech Republic and Romania combined. **The scale and diversity of the economy as well as large base of potential targets (26% of all CEE companies) translate naturally into a relatively high M&A activity (vs. other countries of the region). Sustained dynamic growth and stable investment environment are however also important factors, which is well evidenced by Turkey's case**, where economic and geopolitical uncertainty have served as a strong disincentive for investors (with a 40% drop in number of M&A deals between the years 2016-2018 and 2013-2015).

On the contrary, **Poland is perceived as one of the most stable economies not only in our part of Europe, but also globally**. It is a good example of economic success-story, with the longest period of uninterrupted GDP growth among all OECD countries (together with Australia) after 1989, not suppressed even by the global financial crisis. **Successful economic transformation, evident benefits of the EU accession, strong economic growth and fast pace of convergence towards standards of developed Western countries have played an important role in attracting investors.**

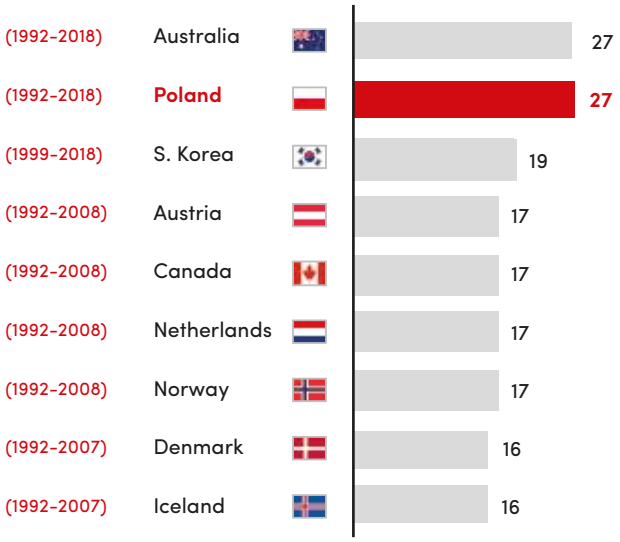
The recent years only strengthened the perception of Poland as an exceptionally stable economy, with GDP growing by almost 14% in real terms since 2015 (vs. 6.5% of growth in the entire European Union). The fast pace of economic growth was achieved at low inflationary pressure (+0,9% on average in the 2016-2018 period), well balanced current account, stable budget deficit and public debt as well as historically low interest rates.

Long-term economic growth of Poland compared to other countries/ regions

GDP growth - Poland vs. EU (%, y/y), 2007-2018



OECD countries with longest uninterrupted economic growth after 1989



* Excluding Poland
Source: Eurostat, IMF

Poland offers also a favorable business climate, which is reflected by global rankings of investment attractiveness

Favourable climate for running a business is also a factor attracting investors. In this field, **Poland has recorded a considerable progress over the last decade, evidenced by improving position within CEE economies in the most prestigious global rankings of investment attractiveness**:

- Poland holds a **leading position in the region** (only behind the Baltic States) **in several consecutive editions of the World Bank's Doing Business** ranking, after the remarkable advance by nearly 40 positions since 2010;
- Poland **occupied 37th place (4th highest in the region, after Czech Republic, Estonia and Slovenia) in the last edition of the WEF Global Competitiveness Report**, recording advance by 11 positions since 2006;
- **The EY Investment Attractiveness Ranking places Poland 8th in Europe** in terms of the number of FDI projects (the highest position among all CEE countries).

Polish enterprises are perceived as attractive acquisition targets thanks to their dynamic growth, strong financial condition and above-average return on equity

Favourable macroeconomic environment has had a strong positive impact on financial situation of Polish companies in the recent years. Their **total revenues and profits have been growing by around 6-7% annually, while the aggregate ROE increased from 8.9% in the years 2013-2014 (the 2-year average) to 9.6% in 2017-2018**, staying roughly 1/5 higher than average profitability of their Western European counterparts.

Strong results and increasing profitability are important factors attracting investors. At the same time, growing financial surpluses made it easier for Polish companies to accumulate capital that may be used for acquisitions.

Poland in select investment attractiveness rankings

Source: World Bank, World Economic Forum, CEOWORLD Magazine, US News, AHK.

Outlook for the Polish M&A market remains favourable

The Polish M&A market presents a large potential for further development. Relatively optimistic macroeconomic forecasts on the one hand and fragmentation of the market combined with its structural challenges (such as demography or succession problems) on the other, should support an increasing activity in this area.

The example of some smaller CEE countries shows that the number and value of transactions on the Polish M&A market is still disproportionately low...

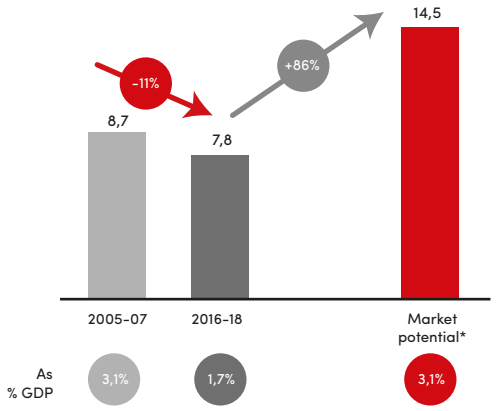
Despite Poland's leading position on the regional M&A market its potential seems to be still not fully exploited:

- **The M&A market value** to GDP (~1.7% in 2016-2018) **is less than a half the one in Czech Republic** (3.9%) **and less than ¼ of ratios in most developed West-European markets** (~7% in UK);
- Moreover, the **ratio declined significantly from 3.1% in the years 2005-2007** (the previous period of exceptionally strong economic expansion in Poland).

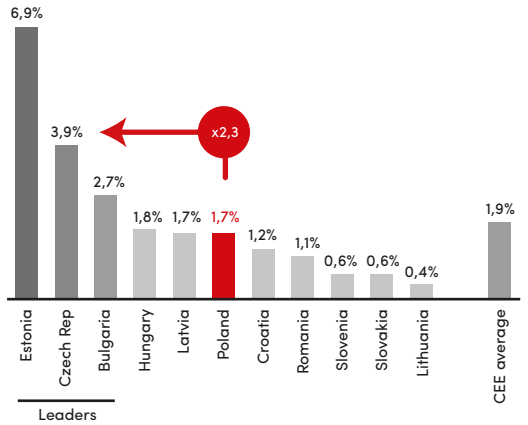
Taking the range 3.1-3.9% as a benchmark, the **potential M&A value in Poland can be estimated at EUR 14-17 bn annually** (versus an average of EUR 7.3 bn of disclosed value in the years 2016-2018).

Growth potential of the Polish M&A market

Value of Polish M&A market (EUR bn) in relation to GDP, 2016-2018 vs. 2005-2007



M&A market value in relation to GDP - CEE countries, 2016-2018



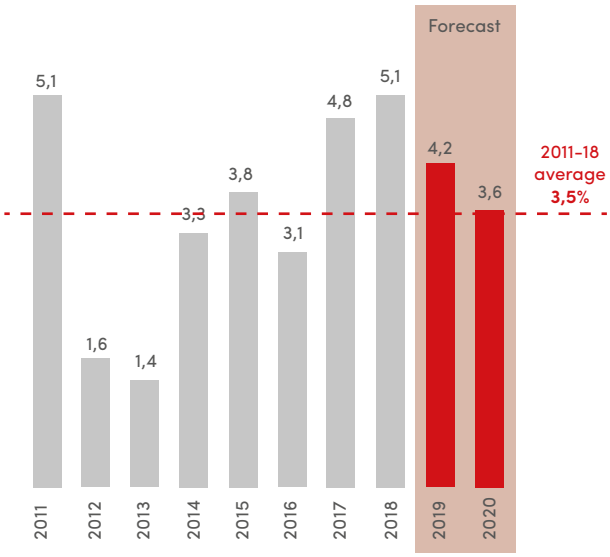
* Hipothetical average yearly value of Polish M&A market assuming identical ratio to GDP as 2005-2007 average
Source: Calculations based on Mergermarket and Eurostat data

Macroeconomic environment in Poland should remain relatively favourable...

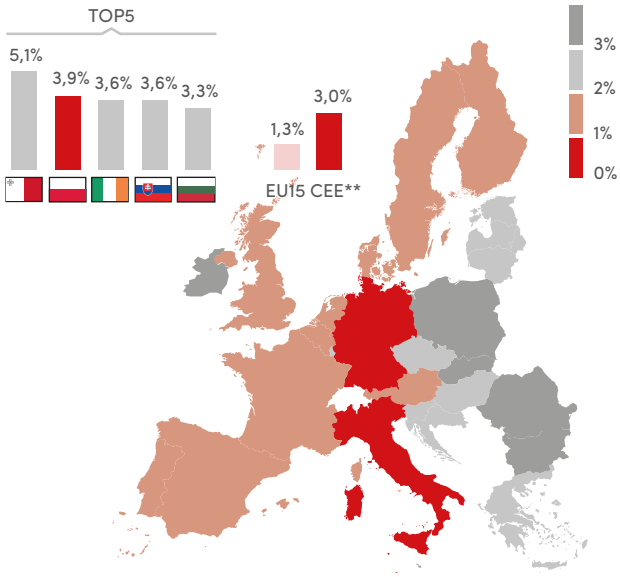
The European Commission's most recent projections for Poland are very optimistic, indicating only a moderate economic slowdown in the coming years. Poland is expected to achieve the highest pace of 2019-20 GDP growth not only in the CEE region, but also among all EU countries (with the exception of Malta). Another supportive factor should be the monetary policy. Relatively low current and expected inflationary pressure, alongside with "dovish" comments from the MPC members, increase probability the central bank will leave its interest rates unchanged at a historically low level until the end of 2020 (vs. expected tightening of the policy in many other CEE countries).

Economic growth forecast for Poland and EU countries*

Historical and forecasted GDP growth in Poland (y/y), 2011-2020



Forecasted average yearly GDP growth for years 2019-2020 - UE countries



* European Commission May 2019 forecast; ** Excluding Poland
Source: StatOffice, European Commission

...while a "game-changing" demographics followed by rising labour costs may stimulate consolidation

The unfavourable demographics and its impact on the Polish labour market may prove to be "game-changers" bringing an end to the simple low-cost business models that dominated Polish economy for decades. In the last few years wage growth in Poland has remained at a historically high level, negatively affecting operating costs and profitability of companies based on labour-intensive processes. And in the coming years this phenomenon may even intensify as demographic projections for Poland foresee a rapid decline in population and its aging. It means that **in longer time horizon Poland faces a structural reduction of available labour force, potentially resulting in its costs growing further regardless the business cycle**.

Structurally higher labour costs will put an increasingly stronger pressure on companies profitability, requiring appropriate answer from their owners. The adjustment may go in two key directions:

- **increasing the scale of operations** - revenue expansion can compensate for the negative effects of rising operating costs;
- **cost side optimization** – through actions aimed at strengthening productivity growth, involving a change in the utilized labour force versus technology / intellectual capital ratio (requiring substantial investment outlays).

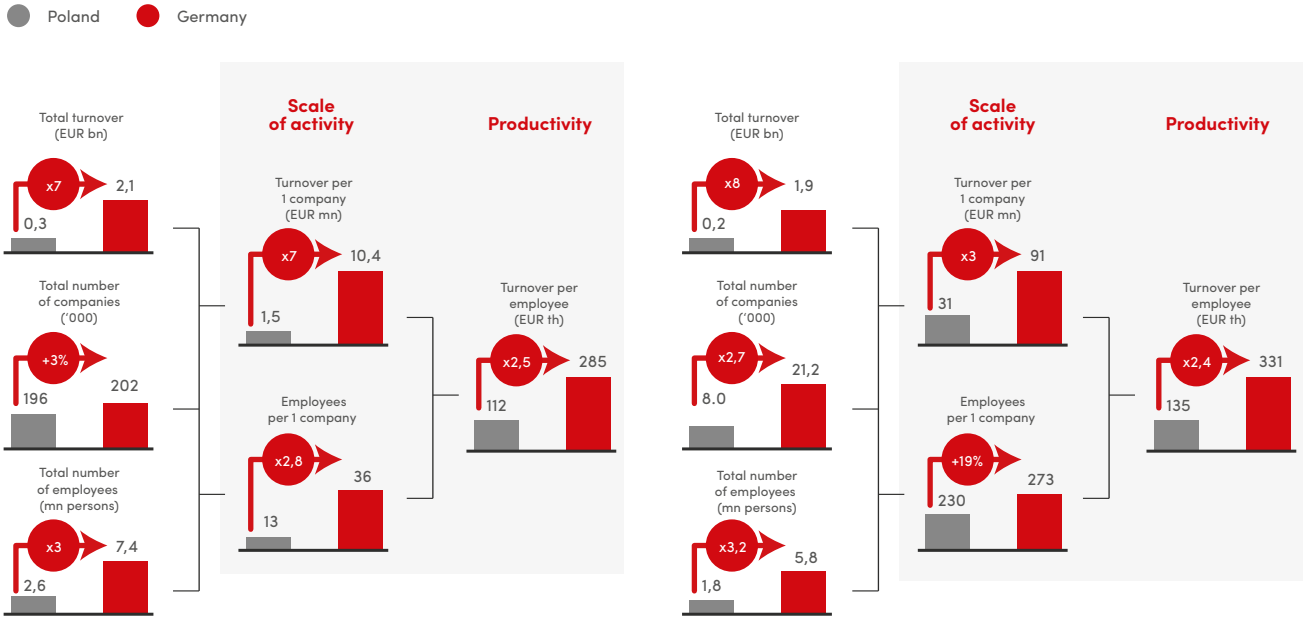
In case of both the scale of activity and productivity Polish companies lag behind their Western European competitors, which can be exemplified through comparison with Germany:

- significantly lower average number of employees and turnover per entity indicate strong fragmentation of the corporate sector in Poland;
- revenues per employee in German enterpises are on average 2-3 times higher than in Poland. Existing differences are stronger among small firms, though they are visible also among mid-caps and large entities.

Intensified consolidation of the Polish enterprise sector may be one of the remedies for its structural weaknesses. Companies seeking expansion, innovation and technological upgrade will look for strategic investors or combine forces to accumulate funds. In turn, owners unsuccessful in adjusting their businesses to rising costs will become more eager to sell their businesses due to declining profitability.

Activity scale and productivity of manufacturing companies - Poland vs. Germany, 2016

All enterprises | **Large and medium corporates (50+ employees)**



Source: Eurostat

Challenges related to succession to be one of the main growth drivers of the Polish M&A market in the upcoming years?

Succession is currently one of the greatest challenges faced by Polish enterprises. Today, more than 40% of Polish family business are 20-30 years old, which means they will need a generation shift in the near future. However, according to various surveys, this **process of transition may not go smoothly due to several factors, including, among others**:

- **visible reluctance of some of the younger generation representatives to take over family businesses from their parents** (due to various reasons - from the ambition of starting their own business to completely different lifestyle and needs);
- **emotional approach of many owners** (and founders) **towards their businesses**, being an obstacle for passing the full responsibility to successors;
- **lack of experience** - as majority of Polish companies face succession for the 1st time.

Under such circumstances, **more and more owners may consider the monetization of their businesses** (by selling them to external investors) as one of the alternatives. As a result, supply of potential targets with succession problems in the background may significantly increase.

Even the cases of successful succession can to some extent stimulate higher M&A activity. Many of the "young generation" owners may seek to implement far-reaching changes to the inherited businesses in the fields of innovation, use of new technologies or expansion into new markets. Implementation of these ideas may require strategic investors willing to provide funding.

Succession in Polish family companies – nature of the problem, key facts

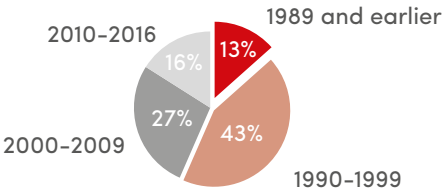
Key facts

828k total number of declared family businesses

18% their estimated contribution to Poland's GDP

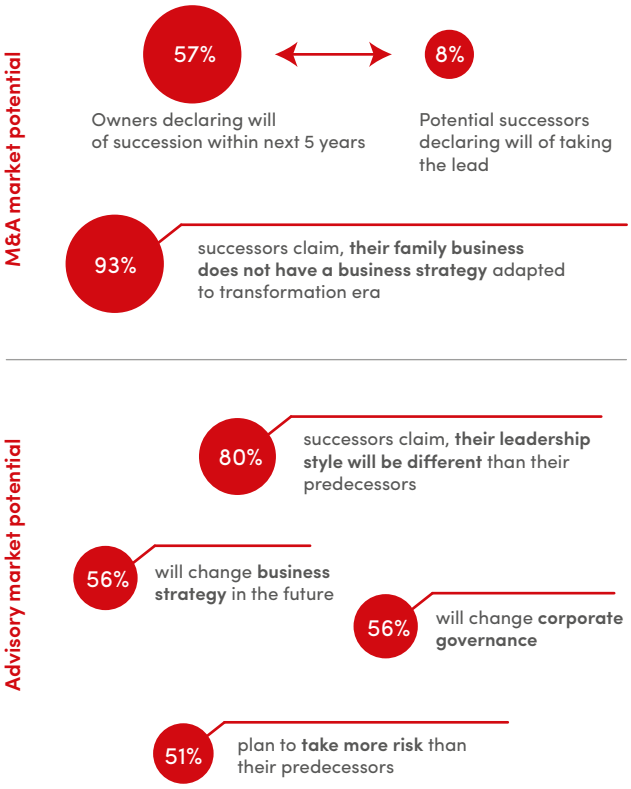
> 50% family companies to face succession challenges in the coming years

Family companies by year of establishment



Source: Institute for Family Business, PwC, Deloitte

Succession = change



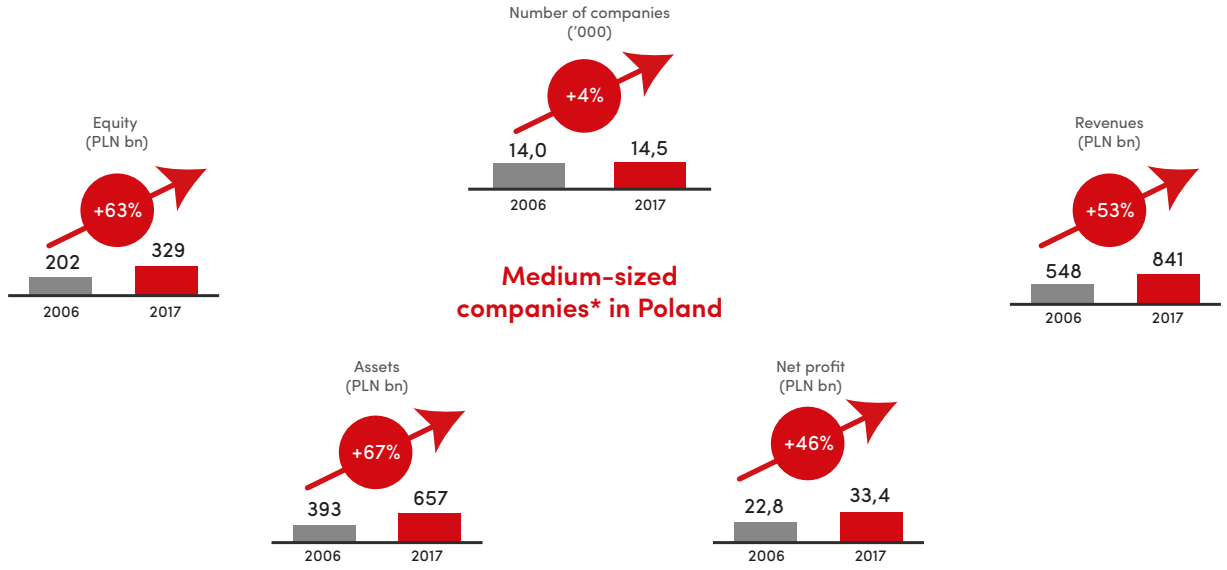
The activity of investors should remain high, with potentially strong stimulus in the mid-caps segment

Summing up, the **Polish M&A market should face relatively stable environment for further development in the forthcoming years**. Negative impact of geopolitical uncertainty and economic slowdown should be neutralized by intensified consolidation trends, the increased number of investment opportunities (increased supply on the seller side) as well as by more favourable companies valuations (bidders' perspective).

It is expected that the number of transactions will remain close to the 2016-2018 average (130-140 transactions annually). The market value may still fluctuate due to exceptionally large transactions (such as the Orlen / Lotos merger expected this or next year), but **its structure should move more towards still under-developed mid-cap segment**.

The Polish medium-sized firms have been expanding over the years at a dynamic pace. Since 2006, their revenues and profits have increased by a half while their aggregate assets and equity went up by nearly 2/3. At the same time, they became much more international (with increasing share of exports in revenues) and some of them developed professional management structures similar to larger entities. **This expansion made mid-caps more attractive targets for takeovers, as well as strengthened their own position as potential bidders.** Combined with succession issues, the mid-cap segment may become important stimulus for the Polish M&A market.

Expansion of medium-sized enterprises in Poland, 2017 vs. 2006



* Enterprises employing from 50 to 249 persons
Source: StatOffice

Bozidar Djelic
Managing Director responsible for Central Eastern Europe, Lazard

Poland will remain investors' key point of interest in the CEE region. Lazard wants to increase its local presence together with Pekao

The growing interest of western investors in Central European markets, including Poland, has encouraged us to increase our presence in the region and find the strongest possible partners in these markets. We have decided to partner with Pekao for Poland, as we appreciate its extraordinary potential of experience, competence and relationships as well as the fact it is an internationally recognized bank, member of the PZU Group. We believe Pekao is the best partner for Lazard in the Polish financial market and has the potential to be a leading financial institution in the entire region.

The growing number of large transactions in Central and Eastern Europe as well as the fact that the region is more and more on the radars of both industry investors and investment funds, will contribute to increase our focus as an active player, serving local customers with our global know-how and top-class advisory. In our view Poland will remain the core market of M&A activity in the region, offering most stable investment conditions and significant growth potential. We also believe - and I will say this on the basis of our unique global experience - that the number of cross-border transactions initiated by companies from the region will certainly grow. We are also convinced that we will see in the next few years an increasing number of acquisitions by CEE-based investors of companies in Western Europe, USA or Asia. Lazard wants to be the market leader for such transactions together with Pekao.

In the upcoming years international M&A activity of Polish companies is expected to grow

Last decade was a period of spectacular growth of exports, thanks to which Polish economy became more open than ever, while local firms gradually transformed themselves into international players. However, increasing export activity is not being followed by a sufficient capital expansion of Polish enterprises.

Polish companies are becoming more and more international and rapidly growing export is the main internationalization channel

For many Polish companies development barriers are associated not only with limited capital capacities, but also with growing saturation of local markets that translates into sales stagnation. Examples include number of food products (e.g. poultry) or garment and shoes. Foreign expansion appears in this context as an obvious solution for further growth. It can be carried out through simple export, which Polish companies have been successfully implementing for years: only during the last 13 years exports ratio to GDP has increased by 20 p.p., to 55% in 2018 – a level similar to that of Germany, considered an exports role model.

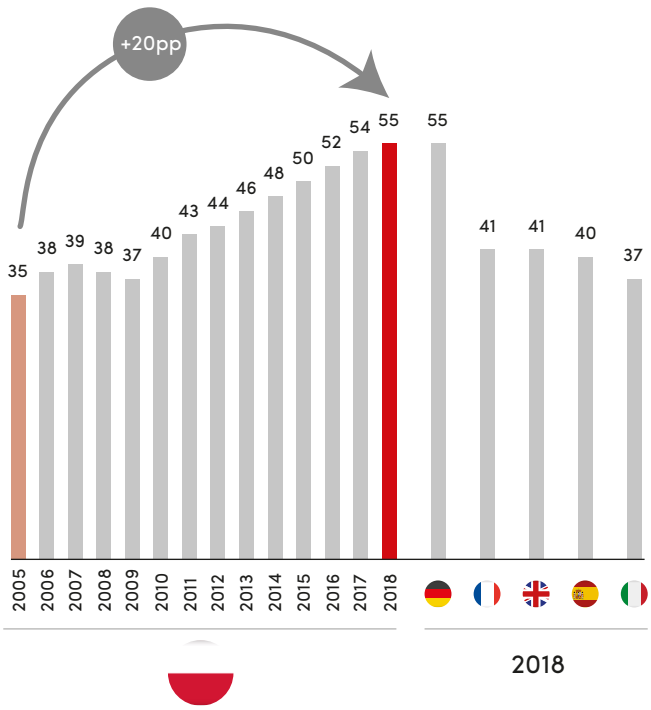
Strong benefits may also come from capital expansion, which Polish enterprises could utilize especially as a gateway to hard-to-reach western markets

Model of foreign expansion based mostly on exports in most cases of CEE firms forces them to position themselves in low-price segments. For enterprises with larger ambitions, who seek not only to boost their volumes but also improve margins, one of the solutions is to acquire local players.

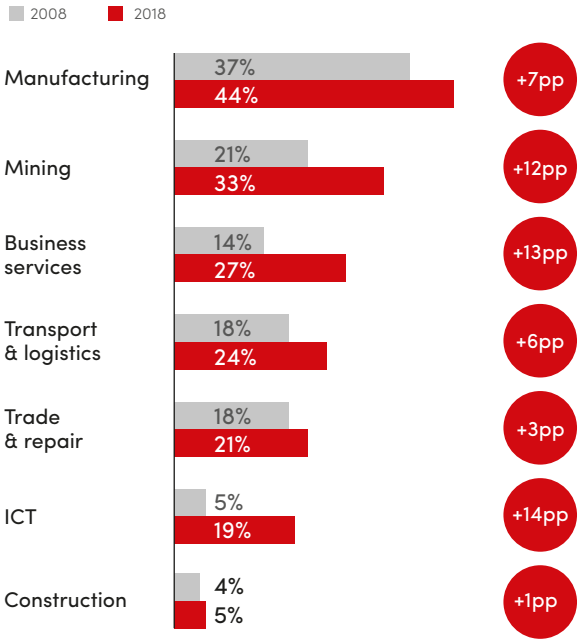
Acquisition of firms on highly developed EU markets proves to be a real challenge for most Polish enterprises due to limited capital capacities and high valuations on western markets. They can however come with invaluable benefits. Most important include an opportunity to enter the market with a brand recognised by local customers, as well as to acquire commercial contracts,

Internationalization of Polish companies

Exports in relation to GDP (%)



Exports as % of companies revenues (by sector)



Source: Eurostat, StatOffice

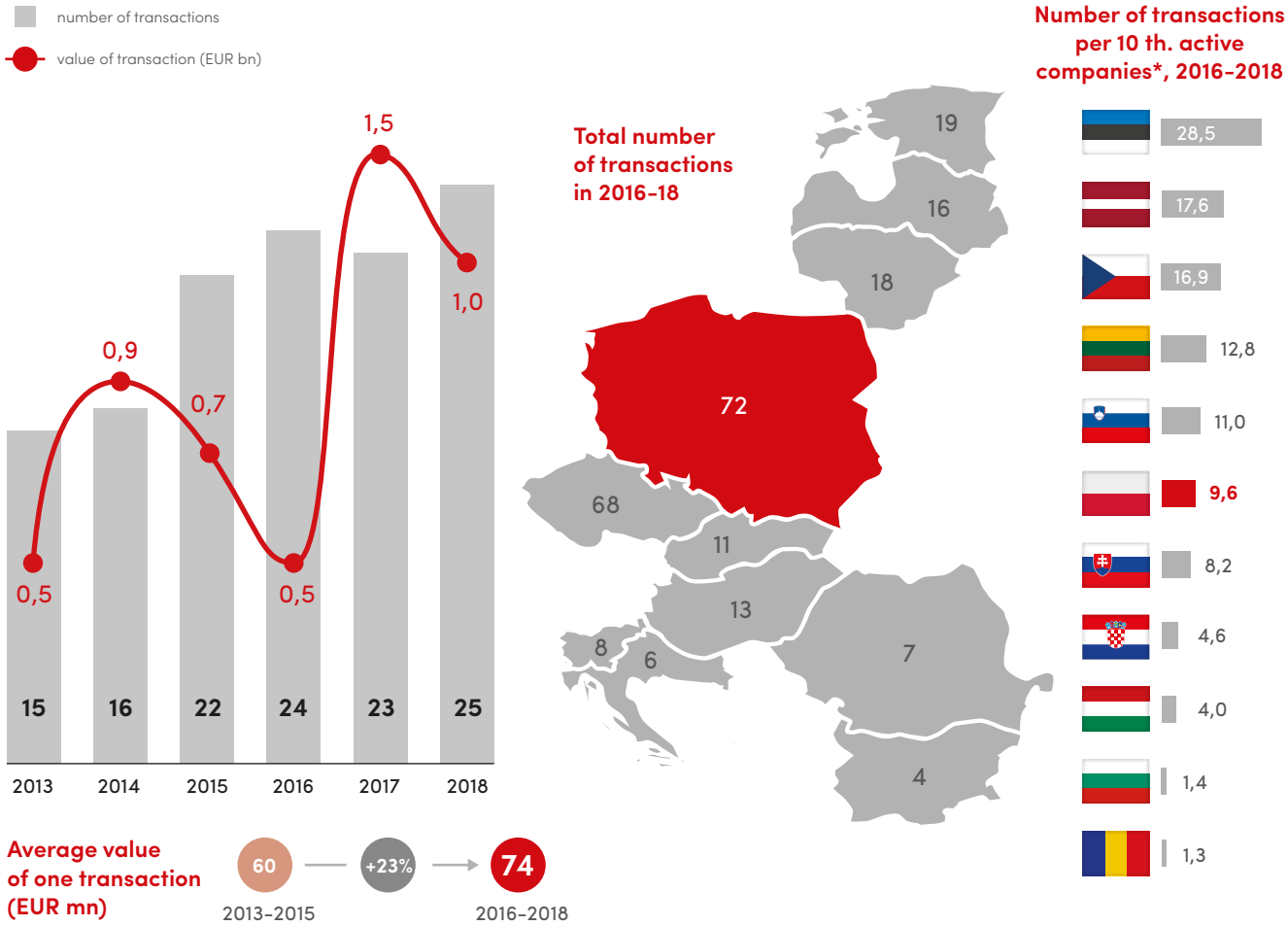
established suppliers or sales network. Additionally such deals may give access to know-how or newest technological solutions.

Moreover, considering the relative size of Polish economy, local enterprises are also natural candidates to play a major role in the region and thus to eye acquisitions both on West-European and CEE markets. Thanks to relatively small scale of activity, companies in other CEE countries can serve as suitable M&A targets. In their case capital barriers are lower, while acquisitions allow to enter markets that are similar in nature and close to the domestic one, making it easier to leverage synergies.

The history shows however that domestic companies aren't fully exploiting the potential of growth through foreign acquisitions

Recent years brought about a significant increase in M&A activity of Polish firms abroad. It was visible both in number of completed deals (24 yearly on average in the period of 2016-18, vs. 18 in 2013-2015) and in average value of one transaction (+23%, from EUR 60m in the period of 2013-2015 to EUR 74m in past 3 years). Even though the presence of Polish companies on foreign M&A markets is gradually increasing, their real capabalities in this field seem to be much greater. Relevant points of reference include Czech Republic or Baltic Countries, where completed international deals in relation to number of total active enterprises is significantly higher than in Poland.

Activity of Polish companies on foreign M&A markets



* Employing more than 9 persons
Source: Mergermarket, Eurostat

Authors:

Krzysztof Mrówczyński, Manager, Macroeconomic Research Bureau, Bank Pekao S.A.
Paweł Kowalski, Analyst, Macroeconomic Research Bureau, Bank Pekao S.A.
Kamil Zduniuk, Analyst, Macroeconomic Research Bureau, Bank Pekao S.A.
Maciej Tyśnicki, Director, Investment Banking Department, Pekao Investment Banking S.A.
Taras Datsenko, Analyst, Investment Banking Department, Pekao Investment Banking S.A.